

ABSTRACT

Title of Thesis: INCOME INEQUALITY AND THE CAPACITY OF THE
STATE IN SOUTH KOREA, 1965-2004

Chang Won Lee, Master of Arts, 2006

Directed By: Professor Roberto Patricio Korzeniewicz
Department of Sociology

This paper focuses on the relationship between income inequality and state capacity in South Korea. Korea achieved rapid economic growth accompanied by equity from the 1960s to the mid 1990s. However, after the 1997 IMF financial crisis, income inequality in Korea increased dramatically. This change in income inequality is closely related to increases in unemployment and underemployment. I argue that such failures in the labor market are attributed to the rapid decline of the state's capacity after financial liberalization in 1993. During the developmental era, the state had been able to form institutions for low income inequality, due to its relative autonomy from business owners. After the financial liberalization no such autonomous capacity to build employment-protective institutions existed, as these reforms increased the influence of domestic and international capital. Further, the weakening of the state's capacity also reflects changes in the relationship of the Korean economy to the world system.

INCOME INEQUALITY AND THE CAPACITY OF THE STATE
IN SOUTH KOREA, 1965-2004

by

Chang Won Lee

Thesis submitted to the Faculty of the Graduate School of the
University of Maryland, College Park, in partial fulfillment
of the requirements for the degree of
Master of Arts
2006

Advisory Committee:

Professor Roberto Patricio Korzeniewicz, Chair
Professor John Iceland
Professor Dae Young Kim

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Dedication

To my parents, Sang Jin Lee and Young Ja Choi

Acknowledgements

I would like to thank my committee members, John Iceland and Dae Young Kim, for their valuable comments and ideas throughout this project. I extend my warm appreciation to my colleagues, in particular, my cohorts Guillermo Cantor, Shyam KC, Nazneen Kane, and Kyle Nelson. Their help out of simple friendship made me enjoy life in graduate school in America. I am also thankful to my friends Kim Ricker and Tom Ricker, and my colleague, Kim Nguyen, for their editorial help. My special appreciation goes to my committee chair, Patricio Korzeniewicz. He inspired me with new zeal to study inequality and gave me many insights on how to do this. My debts to him are huge.

Most of all, I want to thank my wife, Yun Jeong Yu, whose unfailing love, pride, and support enabled me to survive this project. I cannot thank enough to my father, Sang Jin Lee, and my mother, Young Ja Choi for their bottomless love and devotion to their son. I dedicate this thesis to them.

Table of Contents

| | |
|--|-----|
| Dedication | ii |
| Acknowledgements | iii |
| Table of Contents | iv |
| List of Tables | v |
| List of Figures | vi |
| Chapter 1: Introduction | 1 |
| Chapter 2: Theoretical Discussion | 6 |
| 2.1. Economic Growth and Income Inequality | 6 |
| 2.2. Relational View on Creative Destruction of Institutions | 8 |
| 2.3. Bringing the Capacity of the State Back In | 10 |
| 2.4. Literature on Income Inequality in Korea | 14 |
| Chapter 3: The Developmental Era: “Growth with Equity” and the Strong State, 1961-1992 | 16 |
| 3.1. U-Curvilinear Pattern of Income Inequality in the 1960s and the First Half of 1970s | 16 |
| 3.2. “Growth with Equity” and the Developmental State, the Late 1970s - 1992 .. | 17 |
| 3.2.1. Developing the Rural Sector | 18 |
| 3.2.2. The State’s Intervention in the Labor Market | 19 |
| 3.2.3. The State’s Control in the Financial Market | 24 |
| 3.3. The Sources of the Strong Power of the State | 27 |
| 3.3.1. Internal Factors: Land Reform and the Elimination of the Ruling Elite Class | 27 |
| 3.3.2. External sources: Japan, the Vietnam War and the United States | 28 |
| 3.4. Linking the Strong State with Inequality in the Developmental Era | 30 |
| Chapter 4: The 1997 IMF Financial Crisis: Economic Liberalization and Increasing Income Inequality, 1993-2004 | 34 |
| 4.1. The Impact of the 1997 IMF Crisis on Income Inequality and the Labor Market | 34 |
| 4.1.1. Uneven Impacts | 34 |
| 4.1.2. Increasing Rates of Unemployment and Underemployment | 35 |
| 4.1.3. Job Security at Risk | 36 |
| 4.2. The Causes of the Crisis: Financial Liberalization and Too Little Regulation of the State | 37 |
| 4.3. The Decline of the State’s Capacity | 41 |
| 4.3.1. External Factors: the Changed Context of the World Economy | 41 |
| 4.3.2. Internal Factors: Growing Power of <i>Chaebol</i> and Neo- liberalization of Technocrats | 43 |
| 4.4. The Impact of the Institutional Transformation on the Labor Market and Inequality | 45 |
| Chapter 5: Conclusion | 50 |

List of Tables

| | | |
|----|---|----|
| 1. | Composition of Employed Persons by Industry, 1960-2000 | 56 |
| 2. | Premium to Education Among Male Wage Labor | 56 |
| 3. | Employment Changes by Gender and Education | 56 |
| 4. | Employment Changes by Industry and Occupation | 57 |
| 5. | Changes in Employment Structure | 57 |
| 6. | Hourly Wages by Employment Type, 2000 | 57 |
| 7. | Major Financial Liberalization Measures in Korea During the 1990s | 58 |
| 8. | Korea's Foreign Debt Profile, 1960-1997 | 59 |

List of Figures

| | | |
|----|--|----|
| 1. | Income Distribution in Korea, 1965-2004 | 60 |
| 2. | The Growth Rate of GDP in Korea, 1971-2004 | 60 |
| 3. | Per Capita Gross National Income (GNI) in Korea, 1981-2004 | 61 |
| 4. | Unemployment Rate in Korea, 1970-2005 | 61 |

Chapter 1: Introduction

Simon Kuznets's classic article, "Economic Growth and Income Inequality" in *The American Economic Review* in 1955, marked a new epoch in studying the relationship between economic growth and income inequality. He hypothesized that income inequality rises in the earlier phase of economic growth, but then starts to fall after reaching the peak. This relationship was described as an inverted "U." Since the publication of Kuznets's groundbreaking analysis, social scientists have paid considerable attention to income inequality trends within countries, and the "Kuznets curve" was treated like an "iron law" for two decades after it first appeared (Moran 2005).

The trend of income inequality in the era of development from the early 1960s to the early 1990s¹ in South Korea (hereafter, Korea) appears to follow Kuznets's classic pattern, except for a brief decline during the earlier phase between 1965 and 1969 – income inequality increased after 1970, but then declined after a peak in 1976. Korea's low-income inequality, accompanied by high rate of economic growth from the mid 1970s to the mid 1990s, has attracted attention, getting named "the East Asian Miracle." (World Bank 1993). Unlike the Kuznets's hypothesis, however, the decline was not the final trend in income inequality. In the aftermath of the 1997

¹ I define the development era as the time when the developmental state leads the economy with its plans for development. In 1961, the Economic Planning Board, a key organization in the state-led development economy, was institutionalized by Park Chung Hee military government. One year after, implementing the First Five-Year Economic Development Plan, the Economic Planning Board had lasted the five-year plans to the Sixth Economic Development Plan in 1991. The development era ended as Kim Young Sam administration that started in 1993 dissolved the Economic Planning Board. Thus, I name the period when the Economic Planning Board played a key role (1961-1992) the development era of Korea.

International Monetary Fund (IMF) financial crisis, income inequality in Korea rose sharply. As of 2004, the Gini index reached 0.344 (See Figure 1). This was almost at the same level of the early 1980s. One may interpret the rise of income inequality as another transient phase during the aftermath of the 1997 IMF financial crisis, and expect that income inequality would revert to its previous level as the Korean economy recovers from the shock of the 1997 IMF financial crisis. However, eight years after the 1997 IMF financial crisis, inequality has remained above the pre-1997 levels, even though the Korean economy had recovered (See Table 2 for the growth rate of GDP and Table 3 for per capita GNI). According to estimates from the Korean National Statistical Office (KNSO), the Gini coefficient of the nationwide households was 0.295 in 1996, but increased to 0.352 in 2000, and remained high until 2004 when the Gini coefficient was 0.344 (See Figure 1).² There is no sign that income inequality will return to its previous level. Instead, increasing income inequality had become the hottest issue in politics and society. In early 2006 many newspapers started to deal with the polarization of income distribution as an important serial story. The Roh Moo-Hyun government also announced the removal of deteriorating income inequality as the first priority of their public policy. In February 2006, the Korean government decided to invest 800 billion Won (equivalent to \$ 8 billion) donated by Lee Gun-Hee, the head of Samsung group, to solve social polarization.

² Gini coefficients in table 2 are more or less underestimated compared with those in table 1. For example, Gini coefficient of 2000 in table 2 is reported as 0.317, while that in table 1 0.352. It seems to originate in the difference of data employed by the two tables. Table 1 uses data for gross income of "households in all areas within country," but data in table 2 are for those of all cities (73 cities). However, regardless data difference, the trends of income inequality between two data are similar. Table 2 shows clearly that increased income inequality continues for 7 years from 1997 IMF financial crisis as well.

Why did inequality increase after 1997? Conventional wisdom assumes that there is a tradeoff between economic growth and equality. Accordingly, one may argue that the increase in income inequality has been an inevitable consequence of economic growth during the same period. However, during the later years of Korea's developmental era, a different pattern emerged; income inequality decreased even when the economy had rapid growth. Some scholars argue that the increase in income inequality since 1997 is the result of the uneven impact the crisis had on different sectors of the economy. For example, Haggard (2000), Henderson (1999), and Kim (2004) argue that lower income workers, the unemployed and the underemployed (the majority of whom were less-educated and female) were more seriously hurt by the financial crisis than higher income ones. Given that in the two years *before* 1997 the Korean economy achieved an unemployment rate of about two percent, it seems certain that the increase in unemployment *after* 1997 among lower income workers affected detrimentally the distribution of income. In that case, a following question should be; why did the rates of the unemployed and irregular workers rise so dramatically after 1997?

There are few studies that attempt to explain the structural mechanism that led to such instability in the Korean labor market. Instead, many simply suggest that instability was the result of the IMF's neoliberal labor market polity by adopted by the Korean state. In that case, though, why did the Korean state apply a neoliberal policy that was detrimental to job security? Why was the government of Korea able to resist pressures for liberalization of the labor market prior to 1997? If income inequality depends largely on the labor market performance, then these questions

should be examined in order to fully explain the increase in income inequality since 1997. This paper focuses on the characteristics of institutional reform undertaken in Korea during the 1990s in order to explain the evolution of income inequality. Institutional configurations are worthy of notice because they influence the setting of priorities for public policy as well as the strategy of actors within the institutional arrangement for achieving those priorities. For example, in a “pure” capitalist institutional arrangement, activities seeking profit can be justified and supported as the first priority. Income inequality issues may be more likely to be treated as a second priority or the inevitable by-product of capitalist economic growth. In such context, institutions in a capitalist society tend to favor profit-making, namely, capitalist groups. Through institutions, the state is more likely to sacrifice equality for the capital’s profit. That is, in a capitalist arrangement, the institutional capacity of capital (*i.e.*, making institutions favoring capital) becomes strong, while that of a state and labor class weakens. Conversely, such an arrangement in power relationships also affects the formation of institutions.

Since the early 1990s, the Korean state fully liberalized the financial market, which weakened the capacity of the state and strengthened that of both domestic and foreign capitalist groups. Such changes in the institutional configuration gave rise to inequality in Korea by making the Korean labor markets flexible. This paper examines why and how Korea has been institutionally changed since 1993, and how such institutional changes have affected income inequality. Considering that it was the state that played a considerable role in Korea’s “growth with equity” development, I pay a particular attention to institutional change with respect to the

state's capacity. In the following section, I discuss theories that guide us in understanding the causes of income inequality with a focus on how institutional configurations and their changes are related to income inequality.

Chapter 2: Theoretical Discussion

2.1. Economic Growth and Income Inequality

The relationship between economic growth and inequality has been hotly debated among social scientists. Neoclassical economics assumes a tradeoff between rising growth and falling inequality; inequality is more likely to enhance growth (See Birdsall's (2000:9) summary). In this view, we are more likely to see rapid growth if income is concentrated in the hands of the rich who are more likely to save than the poor because a high level of savings and resulting investment is a prerequisite for rapid growth. Also, inequality provides an incentive for individual economic activities such as productive risk-taking and innovation that ultimately ensures higher output and increasing productivity. The result is higher average income and rates of growth. The neoclassical view tends to be negative concerning intervention by a state such as tax-financed transfers because such interventions undermine individual responsibility and the work ethic. As neoclassical arguments are based on assumption such as: "economic problems should be solved by economic ways" and "the less political interference the better economy," they are less likely to consider political/institutional dimensions in their explanations.

Kuznets (1955) raised a different view than the "tradeoff" thesis. He characterized the pattern of inequality in the process of economic growth this way: "Widening in the early phases of economic growth when the transition from the pre-industrial to the industrial civilization was most rapid; becoming stabilized for a while; and then narrowing in the later" (Kuznets 1955:18). Growing inequality in the earlier period of economic growth occurred because of a demographic shift from rural

to urban areas. Kuznets draws his income inequality pattern from two assumptions. First, the average per capita income of a rural population is usually lower than that of an urban population. Thus, the migration from the agricultural to the industrial sector contributes to economic growth by increasing per capital income. The second assumption is that income inequality for a rural population is somewhat lower than for an urban population. Thus it can be inferred that the more urban a population, the greater the inequality. With these assumptions, Kuznets argues that the compositional change by such migrations tends to increase income inequality in the early stage of industrialization.

However, income inequality declines after a peak. As an equalizing mechanism, Kuznets noticed the institutional effect of urbanization. Kuznets argued,

The major offset to the widening of income inequality associated with the shift from agriculture and the countryside to industry and the city must have been a rise in the income share of the lower groups within the nonagricultural sector of the population ... Once the early turbulent phases of industrialization and urbanization had passed, a *variety of forces* converged to bolster the *economic position* of the lower-income groups within the urban (Kuznets 1955:17, emphasis by the author).

That is, increase and convergence of lower-income work force to urban areas brought about the growing political power of that group, thereby leading to a variety of protective legislation to counteract the worst effects of rapid industrialization and urbanization. This was accomplished through the institutional and political changes inherent in the “dynamism of a growing and free economic society”(Kuznets 1955:9).

In sum, Kuznets believes there is an equalizing force in “modern” system (vis-à-vis a “traditional” society) in both economic and political areas.

From the 1970 to the middle of the 1990s, the inequality trend in Korea appears to follow the U-curve. The Gini coefficient peaked in 1976 (0.391), stayed for a few years, then declined from the early 1980s. The mechanism that lowered the gap in Korea was, however, quite different from Kuznets’s hypothesis. It was the state that led the modernization of Korea and rapid economic growth. In this process, the state controlled strongly the working class as well as the capitalist class. The urban working group had been considerably weak in bargaining power until 1988 (Haggard and Moon 1990; Haggard 2000; Lie 1998). Moreover, Kuznets’s theory cannot account for the rise of income inequality after 1997; in his theory, the inequality should have decreased in the latter 1990s when Korean society was already democratized and labor was unionized as well. This implies that other factors that Kuznets was missing may have influenced income inequality in Korea

2.2. Relational View on Creative Destruction of Institutions

An alternative theory on the relationship between economic growth and income inequality has recently been published by Korzeniewicz and Moran (2005). Critiquing single transition from traditional to modern array in Kuznets, Korzeniewicz and Moran (2005) insist that institutions need to be understood as incessantly changing and therefore a transition of distributional array has no an ending point, but it is ever changing. Such their view on institution came out of Schumpeter’s perspective on capitalism. Schumpeter understood the mechanism of

capitalism as a process of *incessant* “creative destruction.” Thus, capitalism should be conceived of entailing continuous transformation, instead of a single transition from one state of equilibrium to another (Korzeniewicz and Moran 2005:297-298). That is, decreasing income inequality in the latter phase in the Kuznets’s curve cannot be expected to remain constant.

The other notable point of Korzeniewicz and Moran’s theory is that the dynamic and evolutionary mechanism of the “creative destruction” is not limited to a national boundary. The process of creative destruction, destroying old systems and creating new institutions for profit, occurs both within and beyond a national boundary. Thus, institutional arrangements are embedded in “international relations” as well as relations among domestic groups.

[I]nstitutions should be understood as *relational* mechanisms of regulation, operating *within* countries while simultaneously shaping interactions and flows *between* nations. In this sense, the same institutional mechanisms through which inequality historically has been reduced within nations often have accentuated the exclusion from wealthy markets of populations from poorer countries (Korzeniewicz and Moran, forthcoming: 20, emphasis in original)

The ‘great U-turn’ in wealthy countries, according to Korzeniewicz and Moran (2005), shows clearly such *relational* aspects of capitalistic growth. The United States, for example, has gone through economic restructuring by neoliberal globalization that removed regulations for a cross-border capital. The globalization of capital placed the U.S. economy in the position of high-tech industry, while consolidating the international labor division. As a result, many manufacturing or labor-intensive industries moved out to the Third World countries for cheap labor,

while high-tech industries requiring high education have been concentrated in the United States. Such deindustrialization in the United States caused the polarization of jobs in the U.S. labor market. This resulted in greater wage differentials between the skilled and unskilled (Galbraith 2001; Ong, Bonacich, and Cheng 1997), which has been referred to as the “hourglass economy.” Moreover, such relational view on institution reveals its importance in restricting some groups’ entry to markets. For example, Olson (1982:163) recognizes, in the particular case of South Africa, that “[t]he denial of various skilled and semi-skilled jobs to Africans not only raised the wages of the European (and sometimes Coloureds and Asian) workers, but it also crowded more labor into the areas that remained open to Africans, making the wages there lower than they would otherwise be.”(recited in Korzeniewicz and Moran, forthcoming: 20).

Such institutional approaches may shed light on understanding Korea’s U-turn after 1997 as it has done so for the United States. We can find considerable changes in the international context surrounding the Korean economy since the early 1990s. I will address in more detail how external situations have been changed and have affected internal institutional configurations in Korea.

2.3. Bringing the Capacity of the State Back In

It seems certain that the world economy shapes institutional arrangements within countries. However, not all countries with comparable levels of development have their institutional configurations impacted in the same way. For example, both Korea and Argentina have been placed in the semi-periphery of the world system as

newly industrialized countries (NICs). Both countries, however, have responded in different ways to the influences from the world economy. They have established different institutions (e.g. import-substitutive vs. export-oriented strategy) for their development. In some ways, their different choices of developmental strategy came from different institutional arrangements between the two countries. In Korea, the state had strong and autonomous power to control other groups during the period of modernization. The traditional elite class, *yangban*, and the labor class had almost no political power. As the state controlled local capital's access to financial resource, capital was controlled and integrated entirely to the state's developmental plans. Likewise, multinational corporations and international finance were screened and regulated by the state. There was, as a consequence, a lack of competing social pressures at the level of institutional political action (Kim 1997; Lie 1998). By contrast, in Argentina, the state had no ability to achieve an institutional and organizational coherence to mobilize efficiently all groups to accomplish the state's own goals like Korea. As a result, social and political conflicts prevented the adoption of an effective development strategy after the early 1950s (Korzeniewicz and Korzeniewicz 1992). To understand fluctuating trends in income inequality one must examine what institutions are established and how the formation of these institutions (and their impacts on economy) is shaped by power relations among economic actors.

Thus, this study focuses on *changing power relations* among main actors in Korea. It emphasizes changes in *the state's capacity* to shape and control the ways in which these actors interact with one another. How should we define the capacity of the state and how should we measure it? Chang (2000:10-11) underlines that there is

no universal measure of the capacity of the state; its definition depends on local context.

The point that we are trying to illustrate ... is that how we measure state intervention matters, because the particular measures that we use embody a particular vision of the role of the state which may not be universally applicable, because the institutional assumptions behind that vision may not hold in contexts other than the one from which that vision emerged. Unless we recognize that different measures of state intervention are based on different theories of the role of the state, which embody different assumptions about the institutions and political economy of state intervention, our empirical investigation of the role of the state will be constrained by the limitations of the theoretical perspective that lies behind the “measures” of intervention that we use (Chang 2000:11).

The degree of state power has often been measured as the proportion of total government budget to GDP and the share of the public enterprise sector in GDP (or total investment). Yet, how “big” the state is does not necessarily correspond to its “strength” or capacity. A state with small budget may still actively intervene in the economy and control other economic actors. Korea is an example. Korea has had a strong regulatory capacity in the era of industrialization, but its budget was not large when measured against GDP. Part of the reason is that the state did not actively execute policies for social welfare via its budget. Rather, private companies took responsibility for providing welfare through programs such as tuition assistance for worker’s children and low-interest-loans for purchasing a house. However, the Korean state had the power to control capital’s (in particular *chaebols*) access to resources. Therefore, while the Korean government’s budget was small but it still

had the power to intervene (Chang 2000:11).

In this context, the definition of state power by Rueschemeyer and Evans (1985) is notable. They argued that the power of a state consists of “autonomy” and “capacity.” State autonomy is defined as the relative autonomy of state officials from dominant economic classes and social groups (Rueschemeyer and Evans 1985:46-50). State capacity refers to the existence of a state apparatus that facilitates the implementation of state policies (Rueschemeyer and Evans 1985:50-53). When possessing these two components, a state can effectively implement its policies. By this definition, the Korean state had strong power in the developmental era. The Korean state had autonomy in the sense that its interest was nation-building through economic growth, and it pursued this goal without interference from other groups (Amsden 1989; Evans 1995). The state had strong capacity as well in that it had organizations that enabled effective execution of economic development plans with discipline and punishment (Amsden 1989). The autonomy and the capacity of the state is embodied in relations of control. Controlling other actors requires such autonomy and capacity.

In this study, the power of the state is defined as its *controlling or regulatory* capacity. The ability to control requires not only executive power of state apparatus but its autonomy. Were it not for state autonomy, active regulation of state apparatus would be more likely to reflect other groups’ interests. In this case we might more accurately say the state is controlled by those groups that benefit from its actions. Therefore, state regulatory capacity is defined as a function of state autonomy. Hence,

I pay special attention to the controlling interests that create institutions and shape their effects on inequality.

2.4. Literature on Income Inequality in Korea

Literature on income inequality in Korea agrees in general that income inequality declined during the developmental period (particularly since the late 1970s)³ (Choi 2003; Choo 1993; Fields and Yoo 2001; Kim and Topel 1995). The literature consistently points to educational expansion as a key factor or mechanism in the falling income inequality of that period (e.g. Birdsall, Ross and Sabot 1997; Fields and Yoo 2000). According to Birdsall, Ross and Sabot (1997)'s research, from 1976 to 1985, as Korea experienced a rapid expansion of education, the wage premium for education declined by 22 percent during that period. Fields and Yoo (2000) also found that education accounted for the largest part (33 percent) of the reduction in the earning gap between 1986 and 1993. The literature suggests encouraging education widely is the key to reducing income inequality. However, this explanation breaks down when looking at the more recent period. Education has been expanding, but the wage premium for education has increased since the mid 1990s. Why has the effect of education on income inequality changed? None of the previous studies provide factors accounting consistently for the rise and fall of income inequality *across* time

³ In Korea, "official" estimation on income distribution began in 1980 by Korean National Statistics Office (KNSO). The "official data" consist of the City Household Income and Expenditure Survey (CHIES) and the Farm Household Economy Survey (FHES). These two survey sampling frames do not include all households in Korea. The CHIES excludes non-farm households in rural areas and single-person households, which are also excluded in the FHES. Besides, in the CHIES there are data only on the size distribution of income of worker households but not those of urban self-employed and employer households. In addition, the CHIES set a household income ceiling and excluded high-income households above the ceiling from the survey (Ahn 1997:29). Thus, Ahn (1997) points out that official estimation is more likely to underestimate gaps in income distribution.

in Korea. This implies that educational expansion is not a fundamental factor for declining inequality in the developmental era. Rather, it can be understood as a consequence of certain deeper foundational factors.

What is (are) the fundamental factor(s) on which income inequality depends? What is the mechanism? The above theoretical discussion shows that Kuznets (1955) and Korzeniewicz and Moran (2005) address the effect of institutional arrangements on income inequality, although they have different views regarding what institutions and how they affect income inequality. Also, many political economists point to the central role of the state in directing the modernization of the Korean economy (Amsden 1989; Chang 2000; Evans 1995; Kim 1997; Lie 1998; Wade 1990). Those theories and historical studies provide valuable insights to explain fluctuation of income inequality in Korea. Adopting their ideas, this study will focus on two points: the autonomy and capacity of the state in shaping and managing other groups for pursuing its own goals and the context of the world economy that affects institutional arrangements surrounding the state's capacity. Then it will study how such changes in institutional configurations are related to income inequality.

Chapter 3: The Developmental Era: “Growth with Equity” and the Strong State, 1961-1992

3.1. U-Curvilinear Pattern of Income Inequality in the 1960s and the First Half of 1970s

Income inequality in Korea declined during the initial period of industrialization in the second half of the 1960s, increased during the 1970s, and then decreased in the 1980s and during the first half of 1990s (see Figure 1).

Unfortunately, there are few studies that explain this fluctuation of income inequality over time. One explanation from literature of the modern Korean history, is that the decline of income inequality during 1960s was due mainly to extensive land reform. Land reform in Korea was initiated after the National Assembly of Korea passed a land redistribution law in 1949 (Lie 1998:9). Land reform was effective in solving rural poverty. It eliminated large landholdings by allowing for widespread ownership of land. As a result, in 1944 the richest 3 percent of farming households owned 64 percent of all the farmland; by 1956, the top 6 percent owned only 18 percent (Lie 1998:12). Such redistribution of land ownership was closely tied to the decline of income inequality because 1960s Korea was an agricultural country where 72 percent of total Korean population was a farmer (Lie 1998:111).

After 1970, income inequality rose until 1976. This period coincided with mass migration from rural to urban areas. Korea in the 1960s and 1970s experienced one of the most accelerated rural out-migrations in world history (Koo 1991; Lie 1998). Mass migration to urban sector was motivated by the state exploitation in rural areas. The government purchased rice about 15 percent below the market price in the 1960s. The state employed this dual-price to lower grain prices in order to feed the

expanding urban working class while also inducing the migration necessary for the state's industrialization plan. This process may have increased the income gap between the rural and the urban sector. Another related reason for increasing income inequality during the early 1970s was the compositional changes of the rapid mass migration that was emphasized by Kuznets. Table 1 illustrates the transformation in the composition of persons employed by industry between 1960 and 2000. The proportion of workers in the primary sector – agricultural, forestry, and fishery industries – declined drastically, while that of the other industrial groups increased remarkably. In the 1960s, employees of the primary sector constituted 79.5 percent of the total economically active population, but this figure was reduced to 8.7 percent by 2000 (Hong 2003:40). Choo (1982) indicates that such urbanization and the emergence of high-income groups in the urban sector accounts for a large part of the widening income inequality in the 1970s.

3.2. “Growth with Equity” and the Developmental State, the Late 1970s - 1992

From the late 1970s until the 1997 IMF financial crisis, income inequality in Korea declined gradually. What reduced income inequality during that period? Because it was the developmental state that established institutions and drove rapid industrialization in Korea during this time, we must address the state's role in our explanation. The Five-Year Economic Development Plans by the Economic Planning Board (EPB) were the primary feature of the state-driven economic development. In particular, the Third Five-Year Economic Development Plan in 1972 led to a

significant period of economic growth of the 1970s. The three main goals of the plan were “the dynamic development of the rural economy, a dramatic and sustained increase in exports, and the establishment of heavy and chemical industries.”(ROK 1971:2, recited from Lie 1998:79). Those clear developmental goals of the state gave birth to institutional effects that contributed to the decline of income inequality after 1976.

3.2.1. Developing the Rural Sector

As mentioned above, in the 1960s, the necessity of cheap grain resulted in the deterioration of the condition of the rural population. It threatened the legitimacy of Park’s military regime in the countryside. Therefore the state began to emphasize rural development in the Third Five-Year Economic Development Plan. It quadrupled the budget of the previous Plan in the rural sector, and constructed dams and power plants. It raised the government price of main staples, particularly rice (Lie 1998:109).

The *Saemaül undong* (New Community, or Village, Movement) was a key project among the state’s various efforts to develop the countryside. It began in 1970 by distributing surplus cement to the rural areas. In an initial stage, the Park administration focused on improving rural living environments. The three goals of the state-led *Saemaül undong* were agricultural mechanization, the spread of high yielding rice strains, and village beautification (Lie 1998:110). In order to maximize its limited resources, the government gave priority to villages with excellent movement records. The program opened the *Saemaül* Leaders Training Institute to

improve the qualifications and capabilities of the trainees, and established a special bureau that organized and assisted the movement and coordinated related projects. To increase income for the rural population, the state encouraged industrialization in the countryside and created off-farm employment that gave rural peoples double income from joint workplaces⁴ (NCSUM 2001).

The state-led rural revitalization movement made it possible to increase productivity and per capita incomes in rural sectors much faster than any other countries (Lie 1998:110). Thus, the gap of income between rural and urban areas closed.

3.2.2. The State's Intervention in the Labor Market

Control over labor class: the regulation of wage and the protection of the labor market

The second developmental goal of the Third Five-Year Development Plan was a “dramatic and sustained increase in exports.” Competitive power in export depended on the quality and (or) the price of exported goods. During the 1970s, however, quality competition had been considered infeasible because of the lack of technology and a foreign-technology-dependent economic structure. Therefore, the only way Korea could compete with other exporting countries was to lower the prices for exports. To gain an advantage in an export price, the cost of production was lowered. Since there were not abundant raw materials in Korea, the easiest way to reduce the cost of production was to lower the cost of the labor force. The state tried

⁴ See the section of “what is Saemaul Undong?” at the website of the National Council of Saemaul Undong Movement in Korea (NCSUM) (www.saemaul.com/english/whatissaemaul)

to maintain cheap labor with an understanding that rising wages for labor would be detrimental to exports as well as economic stability (Koo 2001; Ogle 1990; Lie 1998).

During the 1970s, the state regulated indirectly the rise of wages by preventing labor union organizing. The 1972 Special Law Concerning National Defense and Security prohibited strikes for workers. The labor movement was often identified as a communist movement in the public statements made by the state. It was thus easy to justify repression against unions. Furthermore, the new Labor Dispute Law in 1980 prohibited any third-party intervention in labor disputes. It was originally designed to block intervention by non-labor groups such as church or student activists, but it also prohibited the Federation of Korean Trade Union (FKTU) and industrial unions to take part in labor disputes. By restricting third-party intervention, the state monopolized the mediation process in negotiations between capital and labor. The state's approval was required for initiating collective bargaining by the law in 1980. That is, labor unions were prohibited not only from striking, but even from negotiating independently (Haggard and Moon 1990:223-225).

However, in return partly for its repressive labor policy, the state protected job security. The Labor Standards Act, for example, regulated the permissible types, durations, and conditions for termination of labor contracts rather than leaving such contracts between employers and employee. Under the act, employers could dismiss regular employees only with "just cause." However, in practice, dismissal was rarely implemented because the definitions of "just cause" were highly restrictive (Yang and Moon 2005:77). As a result, Korea was one of highest ranked countries among

OECD members regarding the strictness of employment protection (Yang and Moon 2005:78).

The state's repression of collective actions by workers accompanied with protective labor regulations, contributed to low inequality; the regulation of the rise of wages provided the condition in which employers could hire more workers; the protective law contributed to the increase in the number of regular industrial workers by prohibiting free dismissal from employers.

The expansion of basic education

Ample labor was requisite to the export-oriented strategy relying on cheap labor. Besides, the change in the state's industrial strategy from light industry to heavy and chemical industry (HCI) in 1972 required educated laborers who could deal with complex machines. The state therefore emphasized the value of human capital and education in order to meet the need. The state implanted the idea that all we can rely on is only human resource (capital) in a country with no natural resources. Mass education was, on the other hand, a by-product of land reform in 1950s. Land reform destroyed *yangban*, the land-based ruling elite class. At the same time, land reform decreased the value of land as a tool for accumulating wealth and power as well. Instead, the value of education increased as an alternative strategy to upward mobility. The state's push, combined with the effects of land reform, resulted in a rapid increase in the Korean education level.

However, we cannot assume that the expansion of education always contributes to a decline in inequality. As a matter of fact, education can either

increase or reduce income inequality. It has two effects together: a composition effect and a compression one. The composition effect refers to the impact of education on increasing income (mostly, wage) inequality. It occurs when the more-educated group moves into higher-paying jobs. By contrast, the compression effect means that expansion of education decreases income inequality. This happens when the scarcity rents by education are eroded as the supply of the educated workers increases (Birdsall, Ross, and Sabot 1997: 104).

Whether income inequality rises or falls depends on which effect is bigger. According to Birdsall, Ross, and Sabot's (1997) study, in Korea, the compression effect turned out to be the dominant one. The educational composition of the Korean labor force changed noticeably from 1976 to 1985: The proportion of high school and post-secondary graduates in the wage labor force rose sharply and the proportion of workers with elementary school or less was reduced to only 8 percent. Along with the compositional change of education, the wage premium of highly-educated workers was reduced. In 1976 Korean workers with high school education earned 47 percent more than primary school graduates; by 1986 that premium had declined to 30 percent. Similarly, the premium earned by workers with higher education declined from 97 to 66 percent.

In contrast, in Brazil, the composition effect dominated. For example, the wage premium earned by workers leaving a university was 159 percent in 1976 and 151 percent in 1985 (see Table 2). The net effect of educational expansion in Brazil over the decade was to increase the log variance of wages by roughly 4 percent, in marked contrast to the 22 percent decline that resulted from educational expansion in

Korea (Birdsall, Ross, and Sabot 1997: 105-106). According to Birdsall, Ross, and Sabot (1997:106), the composition effect appeared in Brazil because the absolute increment of well-educated workers was too small to offset the premium of the highly educated. Applying this logic to Korea, we infer that the compression effect in Korea was due to the large-and-rapid educational expansion as the ample supply of the educated labor force removed the premium.

However, educational expansion alone is not sufficient to reduce income inequality, given that the wage premium by education in Korea began to rise since 1990s despite continuous expansion of education for all segments of the population. In addition to educational expansion, abundant jobs thanks to rapid industrial growth contributed to the low wage gap. Meanwhile, the growth of the capital-intensive heavy and chemical industries (HCI) should have served to increase the wage premium by educational achievement. Nevertheless it had been kept low due to the state's control of the labor market that prevented the rapid increase of the wage of the highly educated. In sum, the state created the demand for labor (*i.e.* plenty of jobs) by pursuing manufacture-based industrialization policy, which led to rapid economic growth. It also produced an ample labor supply by expanding education and restraining the rise of wages, which resulted in low income inequality. That is, the state's strong intervention in the labor market played a key role by increasing both the labor supply and demand for labor in accomplishing the "growth and equity" during the industrialization period.

3.2.3. The State's Control in the Financial Market

It is certain that the success of rapid transition to an industrial country in Korea contributed significantly to low income inequality through providing plenty of job opportunities. How did Korea achieve such success in the labor market performance while other regions (*e.g.* Latin American countries) failed? Different consequences in developmental outcomes, according to Evans (1987), come from the difference in the configuration of a triple alliance between states, local capital, and multinational capital. Namely the outcomes depend on whose and what interests are accomplished among three actors' interests. In Latin America, for example, the states were a critical actor, but the interests of private capital predominated (Evans 1987). Transnational corporations also influenced no less than the state and local capital on policies by using the interests of local private capital successfully to oppose or at least to reshape policies that they found threatening (Evans 1987; Korzeniewicz and Korzeniewicz 1992). The Korean state, in contrast, controlled both local and multinational capital (Lim 1985; Lie 1998; Evans 1987; Kim 1997; Korzeniewicz and Korzeniewicz 1992). In fact, capital groups have an attribute to pursue their own profit. Schumpeter's creative destruction describes that they change incessantly their objectives to invest and institutions for their new profit sources (Korzeniewicz and Moran 2005). Therefore, capitalist groups are often uncooperative in the state's developmental plan when particularly their new strategy does not fit the state's plan. In this case, a state should regulate such a capital's diverse and uncooperative investment in order to achieve coherently the state's blueprint for industrial development. The Korean state controlled successfully capital groups – not only

domestic but transnational capitalist groups, while the states in Latin America failed to organize resolutely capitalist groups' interest according to the state's own plan.

How could the Korean state control both domestic and international capital? The part of the power source was found in the fact that the Park regime was relatively *autonomous* from particularistic economic interests (Cumings 1987: 73). The interest of Park Chung Hee was not to protect particular interest groups. His aim was nation-building itself. He stressed the imperative of national autonomy and ruled over the country with *jaju* (self-reliance) philosophy. He said, "Succinctly speaking, *jaju* means we should be the master of our own house (Lie 1998:82)." The state's interest in building a self-reliant industrial structure did not allow a direct investment by foreign capital and multinational corporations. In the case that foreign capital can invest directly in the local economy without any regulation, it is less likely that the state can pursue its own goals because it is more difficult to regulate or induce foreign capitalist groups to invest in the state's selective industries than to pressure local capital.

Despite such concern, however, the state had to rely on foreign capital in industrializing the economy according to its plan, because of the lack of crucial resources such as money, technology, and organization skill. For preventing interruption by foreign capital in the developmental plan, the Korean state intervened deeply in all transactions with foreign capitals (Lie 1998: 81). In particular, it regulated multinational corporations and foreign capital. Domestic industrial capital (particularly *chaebols*) could not autonomously gain access to foreign capital. They

relied on government-controlled credit institutions (Kim 1997; Lee 1997). In short, “the state became the fundamental source of capital and credit,” states Lie (1998:82).

As one of the efficient ways for controlling the *cheabol*'s access to the foreign capital, the state relied on foreign loans, rather than direct foreign investment. Some research shows that the direct foreign investment is more likely to increase economic inequality within countries (*e.g.* Bornschier, Chase-Dunn, and Robinson 1978). The difference in the effects of the direct foreign investment and the foreign loans on inequality becomes clear by comparing Latin American and East Asian countries. Many countries in Latin America relied on the direct foreign investment. Prior to the emergence of an authoritarian state, these societies had been already penetrated by direct foreign investment. It made it difficult for the state to control and manage industrial sectors, thereby making it hard to pursue consistently its own development strategies. By contrast, in Korea, the authoritarian regime controlled financial resources by accepting foreign loans instead of direct foreign investment. It was possible because the state was already in command by the time foreign investors began to take a real interest. As a result, the state was able to pursue consistently its own goals and strategies, and at the same time, could autonomously determine from the beginning what role transnational capital would play in the industrialization. The state's great power vis-à-vis the local capital also made the state a much more attractive partner for multinational capital. Local capitalists who wanted foreign loans needed government approval and repayment guarantees. Thus reliance on loan capital contributed to expanding the state's capacity in Korea rather than undercutting itself.

3.3. The Sources of the Strong Power of the State

3.3.1. Internal Factors: Land Reform and the Elimination of the Ruling Elite Class

It is impossible for the state to implement strong regulations without autonomy and strong capacity. What were sources of the autonomous power of the Korean state? How was the state able to play such roles? Evans (1995) argues that the ranges of roles that states can pursue are defined by structures. In other words, developmental outcomes depend on whether these states' roles fit the surrounding social context and how well they are executed by political elites. In terms of social context, land reform was a key social structure to provide the state with strong capacity. Land reform removed existing ruling class (*yangban*), by destroying their power base, land. It allowed the Korean state to have autonomous power to promote industrialization and control over other competing groups who might hinder it. Historical evidence shows that the agrarian elites tended to impede industrialization because they have no incentive to invest economic surplus in manufacturing. They are more likely to reproduce *the status quo* by preserving their source of privilege. In this way, eliminating the landowner class contributed to industrialization (Lie 1998: 13-14). On the other hand, the continuance of landlords' power often resisted industrialization in some developing countries. The Philippines illustrates this case; in 1950, the beginning of the postcolonial era, the Filipino government did not accept land reform recommended by the U.S. government. Without land reform, landholders were able to hold their power as well as land. As a result, the strong landlord class impeded the industrialization of the country by strongly influencing the choice of

export-oriented agriculture as a nation's developmental strategy (Lie 1998:14). In Argentina, likewise, landowners played a key role in the formation of the modern economy after the 1860s. They challenged state policies promoting industrialization, and as a result, hindered the growth of manufacturing (Korzeniewicz and Korzeniewicz 1992: 84). The Korean state, however, was able to avoid such conflicts in establishing developmental strategies as the ruling class was destroyed by land reform. It empowered the state to plan developmental policies independently and control various factors as well as foreign and domestic groups.

3.3.2. External sources: Japan, the Vietnam War and the United States

The formation and transformation of institutions within countries are affected not only by internal sources but also by the external environment to which a country is related (Korzeniewicz and Moran 2005). Rapid development in Korea was possible thanks largely to the geopolitical conditions favoring Korea's industrialization. Notable are the transformation of the Japanese economic structure and the Vietnam War. First, by the late 1960s, the move of Japan to higher value-added industries provided Korea with the chance of industrialization through Japan's old industries. Despite the prevalence of anti-Japanese sentiments, for reasons of economy, Korea made a normalization treaty with Japan in 1965 (Lie 1998:59). At that time, Japan was well on its way to becoming an economic superpower; it had not only the capital but the technological know-how as well. Reestablishing a diplomatic and economic relationship with Japan incorporated the Korean economy into a Japanese economic zone. In production, the development of Korean enterprises relied largely on Japanese

technology and the diffusion of Japanese skills. In particular, as Japanese corporations turned to less-polluting and higher value-added production, Korean companies were easily handed down the technology and machinery of low-technology, pollution-production, and labor-intensive industries that Japanese corporations had abandoned (Lie 1998:60). Korea had little competition for taking over Japanese old industries and markets. In Latin American countries, the state did not have as active efforts for industrialization as the Korean state. They were content to promote agriculture and to export raw materials (Lie 1998:69). In Asia, only Taiwan had capital, technology and industrializing efforts to develop those industries. Other Asian countries had cheap labor, but their capability was insufficient to take on the industries. The move of the footwear industry is an illustrative example. As Japanese labor costs increase, Nike and other shoe manufacturers began to move to Korea (Korzeniewicz 1994). Korea's cost-effective mass production capability (Gereffi and Korzeniewicz 1990:59), by combining high levels of technology and skill and low labor cost, attracted shoe factories. Although the labor costs in Thailand and other Southeast Asian countries were as low as that in Korea, but the technology and skill to produce shoes were not as developed as those of Korea (Lie 1998:87).

Second, the Vietnam War also served significantly to promote Korea's rapid industrialization. The demand generated by the Vietnam War provided a crucial niche for Korean light industrialization and export in the late 1960s. The U.S. war economy generated demand for Korean light industrial goods, such as plywood, shoes, and textiles. While exports to the United States accounted for 30 percent of the total in 1964, the figure increased to 37 percent in 1966 and 52 percent in 1968 (Lie

1998:64). Moreover, with involvement in the Vietnam War, the Park regime received political and economical support from the U. S. government. The U.S. military continued to be stationed in Korea and doubled aid after Korea sent its troops to Vietnam. Park Chung Hee and many Korean officials were aware of economic opportunities from wars in other regions, noticing the resurgence of the Japanese economy in the early 1950s through the Korean War. A Korean told *Newsweek* (February 7, 1966:37), “In the Korean War, the Japanese made the money while we Koreans did the fighting... Now it is Korea’s turn.” (Lie 1998:63).

Along with the Vietnam War effect, the geopolitical environment served to support Korea’s export-led development. During the Cold War, the U.S. recognized Korea as a place of strategic importance. The U.S. expected Korea’s success to serve as proof of the superiority of capitalism. Therefore, the U.S. supported Korea’s export-led development not only as a material supplier but also as the biggest market for Korea’s export. Furthermore, the U.S. did not pressure Korea to open up domestic markets, and remove protective labor market policies. The Japanese industrial transformation, the Vietnam War, and the U.S.’s support integrated the Korean economy into the expanding U.S. and Japanese economic spheres, providing favorable environment for the Korean state’s export-oriented developmental strategy. This resulted in strengthening the capacity of the developmental state as it led successfully the transformation of the Korean economy into the export-led economy.

3.4. Linking the Strong State with Inequality in the Developmental Era

Korea showed the “growth with equity” pattern during the developmental era. This was possible through the control of a strong developmental state over capital and labor. Land reform served as the social condition to allow the state to have such power by removing the land-based ruling (or capital) class who were more likely to resist the innovative industrialization of the state. In addition, in the tense situation of the confrontation with North Korea, the strict anti-Communist policy of the Park Chung Hee military government justified the state’s strong control by using the metaphor of nationalism. Based on such social conditions, to begin with, the Korean state controlled banks; it nationalized commercial banks and fully subordinated their lending decisions to developmental strategy (Shin and Chang 2003:13). The state designated strategic industries and selected companies or business groups to undertake the task of building these new industries and provide them with subsidies and protections. Besides, the state did not allow free access of local companies to foreign capital. Although Korea heavily imported foreign capitals and technologies, the state limited the influx of foreign direct investment (FDI). It was proved that the share of FDI to gross fixed capital formation in Korea remained the lowest among the East Asian NICs with just over 1 percent during 1970-90, while Korea’s reliance on foreign debt was the highest among them (Shin and Chang 2003:12). It meant, on the other hand, that the Korean state prevented free investment of foreign capital in the Korean economy.

With its autonomous power, the Korean state undertook economically independent nation-building. Since 1961, the Park military regime established national plans for economic growth, and powerfully carried it out to make up for its

lack of legitimacy. As a principal developmental strategy, the state chose an export-oriented policy. Given the weak competitive power of the local enterprises in the initial stage, the state protected the domestic economy from foreign capital and competition with foreign goods; increased the productivity by expanding education widely; and guaranteed the continuing high profit rate of local capital by regulating the rapid increase of wages through prohibiting workers from unionizing. By way of compensating for such repression, the state employed the protective labor market policy that prohibited dismissal without “just cause.” It consolidated job security. The export-oriented policy contributed to produce abundant jobs to absorb most of rising urban workers in manufacturing industries. This condition affected the compression effect of education that lowered a wage premium for education. In addition, as a by-product of the state’s labor policy, the Korean labor market of that time was not segmented by firm size in terms of wage level. Workers in the same kind of occupation or industry earned similar wage levels. Besides, wage gaps by occupation and industry were relatively low. This mechanism explains the low income inequality during the high growth period in Korea.

Meanwhile, we need to consider the situation of the world economy during that time. During the Cold War, for geopolitical reasons, the United States supported the growth of the Korean economy by serving as a market for Korea’s exports as well as by tacitly approving Korea’s protective trade policy. Japan’s ascendance provided a niche for Korea. Korea was handed over not only technology but markets for export from Japan. Korea did not face severe competition with other developing countries in occupying the industries abandoned by Japan. The Vietnam War served to promote

dramatically Korea's exports. Low competition in export also played a significant role in Korea's rapid growth.

Given Korea's concentration on heavy and chemical industries in the 1970s and information technology in the 1980s, Korea's rival in export would have been developed countries. But the rich countries were struggling with rising labor costs. There were, besides, few developing countries that participated fully in the world export market with the advantage of lower labor cost.

In sum, the rapid growth in exports expanded significantly the demand for labor, and the state met the increasing demand by producing ample labor supply through educational expansion and urbanization. In addition, the state removed job insecurity with job-protective labor laws. Those mechanisms resulted in superior labor market performance (Cortázar, Lustig, and Sabot 1998:193-199), which was a key factor in lowering income inequality in the developmental era.

Chapter 4: The 1997 IMF Financial Crisis: Economic Liberalization and Increasing Income Inequality, 1993-2004

4.1. The Impact of the 1997 IMF Crisis on Income Inequality and the Labor Market

4.1.1. Uneven Impacts

Most studies on the social impact of the Korean financial crisis agree that the country's income distribution deteriorated after the 1997 IMF financial crisis. Korea's Gini coefficient was relatively lower than that in most other developing countries until 1997, but the Gini coefficient of nationwide households soared to 0.352 in 2000 and remained high at 0.344 in 2004 (See Figure 1). Consistently, the relative income shares of decile income groups appeared to be more unequal. Cheong's (2001) study finds that the income shares of the lower four groups have decreased to a greater extent *after* rather than *before* the IMF financial crisis, while the income share of the richest group has increased. The income shares of the middle-income groups from the fourth to the seventh deciles significantly declined both in absolute and relative terms compared to the rich (the top two deciles) – from 0.97 before the crisis to 0.77 in the first quarter of 1999. The income share of the middle groups relative to the poorest two deciles increased by over 10 percent after the crisis (Cheong 2001:45). The study by Haggard (2000) supports these uneven consequences of the crisis. According to Haggard, the fall in income in Korea was most serious for the poorest 20 percent (-23.7 percent vs. -2.5 for the top 10 percent) (Haggard 2000:197). He insists,

The crisis affected precisely those emergent, transitional, weakly organized 'starving classes' to which growth-with-equity model had historically granted

social mobility, pushing them back, at least temporarily, into the urban informal sector or the countryside.(Haggard 2000:198)

4.1.2. Increasing Rates of Unemployment and Underemployment

Rising inequality after the Korean financial crisis was closely associated with rapid increases in unemployment and underemployment. Unemployment was most conspicuous (see Figure 2). Normally below three percent in the early 1990s, the unemployment rate climbed to 6.8 percent in 1998. This is a record high for Korea. Moreover, unemployment was unevenly distributed. Women, the uneducated, and workers in manufacturing or construction industries were more likely to be dismissed or less likely to secure a job (See Table 3 and Table 4). The rate, furthermore, does not include hundreds of thousands of unemployed people who had given up on finding jobs. One estimate in 2001 showed that as many as 490,000 individuals had given up on looking for works (Kim 2004). Leading to this figure is the fact that the labor force participation rate declined from 62 percent in 1996 to 60 percent in 2000 (Jang 2003:55). If that number were included, the unemployment rate in Korea would have risen by at least 2 percent (Kim 2004:223).

As of 2005, the unemployment rate has gradually decreased to 3.7 percent, but the figure is still higher than its pre-crisis level (See Figure 4). The decline in the unemployment rate was possible by the sharply increasing employment of temporary and daily jobs, not by the increase in regular jobs. The official unemployment rate does not include millions of day laborers whose jobs often require their services for less than a month. Table 5 shows that the proportion of non-standard or irregular workers exceeded that of regular workers in early 1999. This proportion of non-

standard workers in the total labor force is the highest among the member countries of the Organization for Economic Cooperation and Development (OECD). Moreover, non-standard workers received less pay than regular workers for doing the same type of works. To illustrate, in 2000, irregular workers, including temporary and daily-hire workers, received less than half of the hourly wages of regular workers (8,225 Won for regular workers vs. 4,031 Won for non-irregular workers; see Table 6). Kim's (2004:224) study also shows that non-standard workers received only 52.9 percent of what regular workers earned for doing the same task in the end of 2002.

4.1.3. Job Security at Risk

The rising unemployment and underemployment rates are, if anything, consequences of the increasing “flexibility” of the Korean labor market. Since the early 1990s, Korea started to make the labor market flexible in the sense that it had the highest ratios of temporary workers in the workforce among the OECD countries (Shin and Chang 2003:56). The financial crisis dramatically accelerated the speed and expanded the extent of its flexibility. Following an agreement with the IMF, the Korean National Assembly passed a bill that legalized layoffs and the right to use “dispatch labor” to substitute workers during union strikes. It also allowed the extension of daily work-times and prohibited wild-cat strikes. The Korean unions had strongly resisted this practice before 1997, but the financial crisis compelled the labor class to settle the removal of job-protection institutions. With the excuse that “the flexible labor market is necessary for the nation’s economy to get out of the crisis and further survive in severe global competition,” the state urged labor to accept the

changes of labor market policy. Meanwhile, the flexible labor market in Korea is mainly attributed to the liberalization policy of the state, since the early 1990s and the 1997 financial crisis (Kim 2004; Shin and Chang 2003). Given that the rising flexibility of the labor market that produced high unemployment and underemployment rates is most detrimental in income distribution in the post-1997 Korea, the analysis on the causes of flexible labor – the liberalization of the Korean economy and the 1997 IMF financial crisis – can shed light on understanding the increasing income inequality in the post-1997 Korea.

4.2. The Causes of the Crisis: Financial Liberalization and Too Little Regulation of the State

The IMF financial crisis in 1997 occurred due to the sudden withdrawal of capital by foreign investors who were threatened by the financial crisis in Thailand in July 1997 (Chang, Palma, and Whittaker 2001). Internally, Korea had no significant slump in the economy until the crisis. Macroeconomic indicators had been “normal”- exports were on the rise; the current balance of payment was improving; prices had been stable, and the GNP growth rate was projected to be around 6 percent (Kim 2004: 221). Nevertheless, why did the 1997 IMF financial crisis occur in Korea?

The immediate cause of the Korean financial crisis was the rapidly increasing vulnerability of the economy to foreign capital. This was a consequence of financial liberalization. In the developmental era, Korean lending decisions were ultimately made by the state, not by the financial institutions. However, from the early 1990s, the Korean government started relaxing its control over the financial sector

significantly and, under the Kim Young Sam government, which came to power in 1993, the liberalization process was greatly accelerated. Financial liberalization allowed foreign capital access to the domestic financial market. At the same time, it permitted the local capitals to raise finance on foreign markets. Table 7 charts the evolution of this process in detail.

As a part of the financial liberalization, the state licensed nine new merchant banks in 1994 and 15 more in July 1996, in addition to the six existing ones before the 1993 liberalization (Wade 2000:154). Since then, borrowing by financial institutions and private corporations dramatically increased, which resulted in the rapid build-up of foreign debt in some years before the crisis. Especially alarming was the rapid increase in short-term debt. During the period between 1993 and 1996, short-term debt held by financial institutions increased from \$11.4 billion to \$39.0 billion, while the increase for private enterprises was from \$7.8 billion to \$22.0 billion (You and Lee 2001:11). Throughout 1997, the short-term foreign debt reached to roughly 65 percent of total debt (Wade 2000:154). The rapid increase of short-term borrowing was due to its much lower transaction costs than those for long-term borrowing. Adding to the short-term debt, the total foreign debt at the end of 1997 stood at an astonishingly high level of \$120.8 billion, which is almost four times the total foreign debt at the end of 1990, \$31.7 billion (See Table 8).

This demonstrates the Korean economy's deep reliance on foreign capital that can be freely withdrawn. The dependence made the Korean economy vulnerable to world financial movements. The fact that the financial crisis in Korea was the subsequent consequence of the South East Asian crises in July 1997 reflected that the

crisis was related to the global movement of finance. The confidence in all Asian economies was shaken by the “domino” effect created by the South East Asian crisis. The Korean financial institutions that invested in the region lost at least \$2 billion between July (the beginning of the Thai crisis) and November (the beginning of the Korean crisis) (Shin and Chang 2003:38-39). Some Japanese banks that heavily invested in the region withdrew loans from Korean debtors in order to improve their balance sheets. The situation caused growing distrust of the Korean economy among foreign investors, and thereby a serious current account deficit and high-profile corporate bankruptcies. This shows how vulnerable the local economy became to global capital since the financial liberalization in 1993.

At a more fundamental level, accounting for the causes of the IMF financial crisis can be largely divided into two perspectives: neoliberal vs. statist perspectives (Hart-Landsberg and Burkett 2001), or “too much state intervention” vs. “too little regulation”(Weiss 1999). The former groups view the crisis as a demonstration of the folly of state intervention in the economy. Despite having praised Korea “miracle Asia” for its free-market policies,⁵ neoliberals (e.g. Krugman 1998) quickly blamed the crisis on “crony capitalism,” what Wade (2000) calls a “gestalt shift.” Neoliberal economists, including those in the IMF, argue that the IMF financial crisis in Korea occurred due to misguided and corrupt investment and lending decisions produced by state industrial policies (Hart-Landsberg and Burkett 2001:403). This brought down

⁵ Neoliberal economists viewed that the success of the East Asian countries was possible due to the “magic of the market.” For example, Balassa and Williamson (1987) argued, “South Korea and other newly industrializing countries (NICs) in East Asia had outperformed the Latin American NICs and India because the scope of administrative controls was much more limited in the four East Asian NICs than in Latin America and, even more, India. ... Capital markets were freer in the East Asian NICs than in Latin America and India.”(Balassa and Williamson 1987:14-15, recited from Hart-Landsberg and Burkett (2001:405)).

the Korean economy by distorting market processes. Neoliberal economists argue that if states had not intervened, there would be fewer distortions blocking efficient resource allocation (Weiss 1999:320). The solutions they suggest for the recovery of the Korean economy are the following: the abandonment of the state-led industrial policies; corporate downsizing including the dissolution of *chaebol*; more rigorous and open accounting practices; and a greater role for foreign capital in shaping and disciplining economic activity (Hart-Landsberg and Burkett 2001:404).

By contrast, the latter, statist (e.g. Stiglitz 2003), groups argue that the state's underregulation rather than overregulation helped to create the 1997 financial crisis. They underscore the success of past governments' industrial policies based on their developmental plans. According to this view, the main causes of the crisis were the opening of the capital account and the laxity of regulatory control over capital flows. Their solution for economic recovery is, therefore, the reregulation of the financial system and the reimposition of an industrial policy (Hart-Landsberg and Burkett 2001:404). In the statist view, if the state were a stronger regulator, preventing dangerous inflows, there would have been no crisis (Weiss 1999: 320).

Both perspectives have shortcomings. Neoliberal economists do not explain why the crisis occurred *after* the economic liberalization. If it is true that the intervention of the state in the economy with its industrial policy was a causal problem, why did not such a crisis happen at the time of the strong intervention by the state? Statists have a far better grasp of the Korea experience than did neoliberals. But their work is also not free from criticism. Statists do not account in detail for why the

state, that was once strong, lost its capacity to control over capital. Is the weakness of the state an endogenous consequence? Otherwise is it from external factors? Or both?

4.3. The Decline of the State's Capacity

The failure of neoliberal groups to account for the Korean case (*i.e.*, the rapid growth under the strong intervention of the state in the economy and the economic crisis after the liberalization) arises from their neglect in considering the roles of the state in the economy. The state may distort the market as neoliberals assume, but at the same time, can play a significant role in the growth of the economy as shown in the Korean case. Statists have provided us with critical insights into the role of the state in economic development, but they do not investigate how the balance of power between the state vis-à-vis other actors in society may change as a result of economic development (Kim 1997:14). This section examines why the Korean state lost its power vis-à-vis capital groups during the period of liberalization.

4.3.1. External Factors: the Changed Context of the World Economy

The decline of the state's capacity has both external and internal factors. Externally, the changing situations of the world-market economy play a role in the loss of controlling power of the Korean state. The late 1990s provided a different world-economy circumstance to Korea than before. The rising global competition for exports led to a rapid decline in export earnings. Notable here is the emergence of Southeast Asian countries and China as competitor nations for exports. Their low

labor costs have more advantage in price competition than Korea. This resulted in a serious trade balance deficit. This trade deficit threatened the Korean economy. Faced with declining profits, *chaebols* moved production overseas not only for low-labor cost, but for expanding export market. The now-defunct Daewoo Group's popular slogan, "*Sae-gye-gyong-young*," (global management) is a typical example of the *chaebol's* strategy – global expansion of production and market. The investment by the Daewoo Group was not limited to Asia; it spread out to European countries such as Poland and Uzbekistan. As a result, by the mid-1990s, Korea became one of the largest foreign investors in a number of developing and transition economies (Shin and Chang 2003:77-78). Such an attempt to capture new market opportunities needs abundant capital. Thus, *Chaebols* demanded the liberalization of the financial market for easier access to cheaper foreign money. The state fully opened the financial market, as the Korean state had changed its attitude to *chaebols* from control to support with the belief that "the competitive power of *chaebols* reflects the very competitive power of the nation."

On the other hand, there was pressure to remove market-protection policies from the United States and other advanced countries. From the late 1980s, recognizing Korea as a now-developed country, industrial nations started claiming that Korea should become more 'responsible' by abandoning all those 'unfair' protections in all the markets including the financial market (Shin and Chang 2003:70). Especially, in the view of OECD countries of which the Kim Young Sam government wanted to be a member, a mature and developed economy was governed by market forces and the desirable type of a state was a relatively disengaged,

economically liberal state (Henderson, Hulme, Phillips, and Kim 2002:17). Thus, The Kim government opened up various markets including the financial market for being a member of OECD.

4.3.2. Internal Factors: Growing Power of *Chaebol* and Neo-liberalization of Technocrats

Internally, the decline of the state's power is a result of economic development itself. Rapid economic growth in Korea transformed the state-centered institutional configuration; it accompanied the growing power of *chaebols*. The *chaebols* that had grown in the protection of the state came to have confidence that they could now stand on their own, as they have succeeded in the exclusive domains of the most advanced economies such as memory chips and automobiles. The protection by the state became unnecessary for *chaebols*. By the mid 1990s, the *chaebols* aggressively demanded the withdrawal of the state from economic management (Shin and Chang 2003:69). In its report in 1997, for instance, the Federation of Korean Industries (FKI), the club of the *chaebols*, called for a radical scale-down of the state including the abolition of all government ministries except for Defense and Foreign Affairs and demanded the consequent reduction of government bureaucracy by 90 percent (Shin and Chang 2003:69).

The decay of the developmental state is also closely associated with the increasing conversion of the intellectual elite, especially bureaucratic elite, to neo-liberalism. As Korea connected closely with the United States in politics and the economy, the number of elite bureaucrats and academics who had a masters or

doctoral degree in economics from the United States increased. Increasing Korea's trade with America and the other Western countries amplified the value of American academic degrees and work experiences in the United States. As a consequence, the so-called ATKEs (American-trained Korean economists) (Amsden 1991) increasingly dominated not only an academic world but also a bureaucratic field in Korea. The majority of technocrats were the ATKEs. Because of their study in the U.S., the ATKEs easily accepted neoliberalism in economics and actively pursued neoliberal economic policy.⁶ In other words, the technocrats increasingly believed the virtues of the free market and saw developmentalism as a 'backward' and 'mistaken' ideology (Shin and Chang 2003:68). The Economic Planning Board (EPB) increasingly consisted of neoliberal ATKEs. The EPB, the symbol of developmentalism, had become the home of neoliberalism in the Korean state. Like FKI, technocrats in the EPB also suggested a retrenchment of the state and especially the abolishment of their own ministry. They viewed planning as no longer feasible due to the increasing complexity of the economy (Shin and Chang 2003:68).

Furthermore, the developmental strategy encouraging education produced a well-educated middle class that pursued democracy and possessed antipathy for the authoritarian military government and thereby contributed to the formation of civil society. The suppression of labor, combined with the rapid growth of manufacturing industries, moreover, brought strong unions.

⁶ Babb's (2003) study of Mexico shows the same tendency. The increasing moves of capital and goods between Mexico and the United States enhanced demand for technocrats who knew the U.S. economy well. The new American-trained Mexican technocrats disseminated neoliberal ideology in Mexico where nationalistic economics had dominated and retrenched the role of the Mexican state in economic development.

These changes considerably weakened the capacity of the state. The state-led industrial policy started to be dismantled since the early 1990s. The hallmark of the end of developmentalism in Korea was the termination of five-year economic development plan along with the abolishment of the Economic Planning Board in 1993. This demise of the developmental state brought about the mismanagement of the financial market that led the 1997 IMF crisis due to incapacity of the state to control capital's reckless access to financial resources (Shin and Chang 2003:70).

4.4. The Impact of the Institutional Transformation on the Labor Market and Inequality

One may view the rising inequality after 1997 as a passing phenomenon caused by the shock of the crisis. That is, one might expect that income distribution would return to prior levels sooner or later as the impact of the shock disappeared and there was an economic recovery. This is not the case, however. Despite the fact that the Korean state completely repaid its IMF loan in 1999, and the Korean economy recovered within a few years of 1997, inequality has remained much higher than before 1997, with a Gini coefficient above 3.0.

Why did inequality not fall to its previous level? To answer this question, one must address the structural changes keeping inequality high. The process of liberalizing the Korean economy and the IMF financial crisis itself transformed the institutional configurations in Korea. For example, economic liberalization and the financial crisis increased the institutional capacity of foreign capital, by rapidly *denationalizing* domestic capital (Hart-Landsberg and Burkett 2001: 414-416). First,

the Korean auto industry was handed over to foreign capital. The Daewoo Motor Company, Korea's second largest car company, was acquired by General Motors (GM). The Renault Company of France bought Samsung Motors. Denationalization occurred in large scale in other manufacturing sectors as well. Sweden's Volvo purchased Samsung's construction equipment operation in 1998, and Philips Electronics acquired a 50 percent stake in LG-LCD in 1999.⁷

As the Korean economy has been increasingly denationalized, labor has faced a crisis in its job security. This is evident in efforts to force unions to accept mass layoffs by foreign managers. For example, in November 2000 as a condition for providing fresh loans necessary for the company's survival, Daewoo Motor's creditors demanded that "the carmaker's union accepted a plan to cut wages and layoff as many as 3,500 workers, or one-third of its domestic work force."⁸ The union did not accept this suggestion, and thereby the creditors refused loans. This result damaged the union. As Hart-Landberg and Burkett (2001:421) observed, "the government, domestic creditors, and the international business press all blamed Daewoo workers for their unwillingness to shoulder their rightful share of the costs of a painful but unavoidable restructuring." This case illustrates the increasing power of foreign capital on the Korean labor market. Given the large number of layoffs and that those whose wages were reduced by foreign managers were largely uneducated and unskilled workers, it can be inferred that the denationalization of the Korean

⁷ The above-mentioned cases of denationalization are cited from Hart-Landsberg and Burkett (2001:415-416).

⁸ Samuel Len, "Automaker on the Brink of Failure," *New York Times*, November 7, 2000, recited from Hart-Landsberg and Burkett (2001:46)

economy was more likely to affect income distribution negatively by decreasing job security in the new “flexible labor market.”

On the other hand, rising pressures from global competition gave *chaebols* strength, while weakened the capacity of the state. Shin and Chang (2003:78) argue, “Globalization gave *chaebols* an important advantage by opening up new, ‘emerging’ markets, entry into which carried high risk and therefore was suited more to the *chaebols* with greater risk-bearing capability than to single-product firms.” Another scholar also agrees the rising power of *chaebols* since 1990s. According to You and Lee, “The winding down of industrial policy was also mishandled because of *chaebol’s influence on the government*”(You and Lee 2000:89; emphasis added). That is, they said the *chaebol’s* power over the state is one of the main causes of the crisis. For example, *chaebols’* power over the state can be seen in the Samsung Automobile case. The Kim Young Sam government allowed Samsung to enter the auto industry, reversing its earlier decision that prohibited its entry. In the view of the state, Korea already had sufficient production of cars for domestic and the world markets. The state might think that it would be more important to support existing auto companies such as the Hyundai motor company to increase car exports to the world market. Besides, building a new car company requires high levels of capitalization, which often means a high reliance on foreign capital. That is, the state viewed Samsung’s entry into the car industry as an inefficient project accompanying high risk. Despite the negative view, however, the state approved Samsung’s expansion to the car industry agreeing to the biggest *cheabol’s* demand. The deal

resulted in exacerbating over-capacity in the economy (Hart-Landsberg and Burkett 2001; You and Lee 2000).

The flexibility of the labor market has a similar story. The Kim Dae-Jung government that started from 1998 accepted the *chaebol*'s demand to remove a rigid protection policy in the labor market. The pro-*chaebol* policy, like the easy layoffs and the use of "dispatch" labor, directly and indirectly affected the level of income inequality. Directly, and most decisively regarding inequality, it brought about unprecedented unemployment and underemployment and dramatically increased non-regular workers, through the "flexible" labor market institution, as mentioned above. Indirectly, it contributed to the changes in the effects of education. As examined in the previous section and as most scholars agree, educational expansion substantially contributed to a reduction of inequality in Korea (Kim and Topel 1995; Lee and Kim 1997; Birdsall, Ross and Sabot 1997). However, in the 1990s, the equalizing impact (*i.e.*, compression effect) of mass education no longer seemed to apply. Rather, the composition effect became more notable. In particular, college premiums started rising in the early 1990s, despite the steady increase of the ratio of college graduates among the labor force from 6.7 percent in 1980 to 12.5 percent in 1988, 17.5 percent in 1993, and up to 23.4 percent in 1998. You and Lee (2001:15) state, "Although the rate of expansion of college education has remained as high since the early 1990s, it has not led to an improvement of educational wage differential." The rise of the college premium is associated with an increasing demand for highly educated labor. There are some indications that the demand for the highly educated has increased since 1992. During the period from 1992 to 1996, the increase in employment in

finance, insurance, real estate, and business services amounted to 30.2 percent of the total employment increase during the same period. This compares to only 18.4 percent during the period from 1988 to 1992 (You and Lee 2001:15).

What changed the compression effect of education to the composition effect? First, the change was due to the structural change in Korean industry. Many manufacturing industries have been going overseas for cheaper labor, while many finance-related industries have grown significantly due to financial liberalization. In the past, the period of the state's control of financial resources, domestic capital, especially *chaebol*, did not need to establish financial companies because they were not able to attract foreign capital without the state's approval. However, once *chaebols* were able to freely borrow foreign money after the liberalization of finance, individual firms also needed to restructure in order to attract and manage foreign capital. It increased the financial industry in Korea. As the financial sector became increasingly important, the wage gap between the financial sector and the non-financial sector became larger. The expansion of the financial industry increased the premium of a college education that was required to enter that industry. As a result, after the liberalization, the impact of higher education has been to increase income inequality.

Chapter 5: Conclusion

Between 1960 and 1990, the Korean economy grew rapidly, retaining relative equity in income. Through both internal and external factors, the autonomous power of the state played a key role in achieving this “growth with equity.” Internally, land reform contributed considerably to the state’s strong capacity. The Korean state was free from undue pressure from the ruling class as land reform removed the basis of the traditional elite’s power. In addition, the Cold War context allowed the Korean state to avoid external coercion from core countries. In the 1960s and 1970s, Korea was considered as a bulwark against international communism in East Asia. This geopolitical situation led the United States and Japan to support the Korean economy through economic aid and transfers of technology. Confrontations with North Korea strengthened the controlling power of the authoritarian military government over society. Such internal and external circumstances strengthened the Korean state’s relative autonomy, and allowed the government to achieve both growth and relative equality.

In the liberalization era since 1990, Korea experienced dramatic institutional changes. The capacity of the state to regulate, especially, *chaebols* and foreign capital weakened. Before the liberalization, the state was able to control access to financial resources for domestic capital and regulate international investment in order to pursue specific developmental goals. However, by allowing financial liberalization, the state gradually lost its leverage in directing development. Instead, the influential power of *chaebols* and foreign capital, including IMF to intervene in industrial policy-making,

became larger. This is particularly evident in reforms for “labor market flexibility.” *Chaebols* argued that strict labor market institutions distorted the market and lessened their efficiency. For the same reason, foreign-capital investors and IMF also urged the flexible labor market as a condition for their investment.

The changes in institutional configurations were due largely to the changing relation of the Korean economy to the world economy. Emerging rival exporting countries drastically reduced Korea’s earnings from exports. The United States and Japan started adopting an “economic” containment policy toward Korea as the Cold War ended and the Korean economy continued to grow rapidly. Neoliberal ideology as a “global standard” also served as a pressure on opening the Korean market. Such external conditions were not the only cause of the weakening power of the state. The internal transformations of the institutions intrinsic in the process of Korean economic growth such as the growing power of *chaebols* and pressure for democratization tended to reduce the capacity of the state, interplaying with the external context.

The liberalization of financial markets was a product of the changed power relationships between the state and both domestic and foreign capital. Financial liberalization strengthened both local and foreign capital, by allowing easier access to loans and/or direct investment by foreign capital. One result of this liberalization was an increase in the foreign debt grew to an unsustainable level. And this situation resulted in the 1997 IMF financial crisis. As a way of restoration, Korea handed over many industries to foreign investors. Mass layoffs were allowed and many jobs were

lost as a condition for selling companies. Unions were forced to accept the easy-layoffs policy by the state as well as *chaebols* and foreign capital.

Such flexibility of the labor market (as a product of the transformed power relationships) including such deregulation for layoffs and “casualization of labor” resulted in the sharp rise of the unemployment and underemployment rates, which were the very causes affecting the largest part of the rise of inequality after the financial crisis (Haggard 2000; Kim 2004; Yang and Moon 2005). Moreover, the flexible labor market, combined with the decline of manufacturing jobs by shifting production abroad, eroded the equalizing factors that existed during the “growth with equity” era. Increased job insecurity – increased unemployment and underemployment – removed the compression effect of education, and instead strengthened the composition effect that widened income inequality. Democratization and unionization made the state’s low-wage policy unattainable, and as a result, widened wage gaps between large companies with unions and the small-and-medium-sized firms without unions (Keum 2004). Moreover, the increasing competition in the world economy and geopolitical changes – particularly the turn of the United States and Japan from economic aid and supports to checks – no longer supported Korea’s export strategy. These factors from the inside and the outside Korea contributed to the rise of income inequality since 1997.

This study on income inequality in Korea argues that Kuznets’s hypothesis must be revisited. First, Kuznets did not pay attention to the *state’s role*. Modernization theorists, including Kuznets, were more likely to think that intervention by a state was unnecessary for lowering inequality. However, in Korea’s

situation showed the opposite was true. Relatively low inequality in Korea during the developmental era was, in fact, due largely to the state's capacity to regulate domestic and foreign capital. The state contributed to the "growth with equity" development model, by creating an institutional environment that promoted an accumulation of individual and collective human skills in production. After 1993, however, the state lost its regulating power by removing EPB that had established developmental plan and by opening fully the financial market. As a consequence, Korea faced a financial crisis. This crisis deteriorated income distribution in Korea. While Kuznets made little account of the role of a state, the Korean case emphasizes the importance of the state's capacity by showing how the loss of the state's capacity affects the labor market and income inequality. The neoliberal perspective – that a state's intervention is always problematic – is therefore disproved by this case. Second, Kuznets overlooked the *relations* of a local economy to the world economy. There was mounting competition and increasing pressure of the world economy behind the changes of institutional configurations in Korea. It lowered the capacity of the state and by the same token reinforced that of capital. Therefore, explanations of income inequality should include the relations of a local economy to the world economy, as well as the regulatory capacity of the state. The causes and dynamic patterns of income inequality in Korea demonstrate the importance of such changes in the institutional configuration as factors affecting inequality.

As an initial effort to link income inequality and state's capacity, this study has limitations as much as it serves as a stepping-stone for future research. First, this study does not pay attention to civil society. In Korea, since 1990s, the power of civil

society has increased considerably. Perhaps civil society, instead of the state, may be able to restrain *chaebol*'s activities that increase income inequality. Civil society's active participation might affect institutional configurations and institutions themselves, thereby playing a role in lowering (or raising) income inequality. Second, this study does not include the case of self-employment. Given its increasing proportion, self-employment should be examined in future studies about income inequality. Third, a comparative study is necessary for generalizing the conclusion of this study. Is the relationship between income inequality and the capacity of the state a "unique" case of Korea or a common pattern to be generalized? We can compare the Korean case with countries that have gone through similar financial crises but had different political context, for example, Mexico. Also, comparative study can provide knowledge about how significant the rise of income inequality was after the IMF financial crisis is. If income inequality in other countries increased more than that in Korea after their financial crises, we can ask how the Korean government was able to restrain the rise of income inequality, even though it did increase some after the IMF financial crisis. Last, it is not clear what caused the decline of the state's capacity. Was the loss of the state's capacity based on the failure of the policy choices by the local state? Or, is it an inevitable process of neoliberal globalization? In terms of this question, Malaysia may serve as a good case to be compared with Korea. Rejecting IMF's neoliberal reform policies, the Malaysian government has not given up on its regulation of the financial market. How could the Malaysian state resist such external pressures? How did maintaining the state's regulatory power affect income inequality in Malaysia?

Understood as an opening to the analysis of the relationships between state's capacity and income inequality, this paper has begun to unravel some parts of the institutional arrangements related to changes in income inequality in Korea. This comparative study across time in Korea indicates that income inequality depends much on how the state and capital respond and reorganize the local institutions in the face of increased competition in the world-economy due to neoliberal globalization. This paper, at the same time, holds the argument that the state should have capacity to regulate the economy ensure more equitable income distribution.

Table 1. Composition of Employed Persons by Industry, 1960-2000 (%)

| Industry | 1960 | 1970 | 1980 | 1990 | 2000 |
|----------------------------------|------|------|------|------|------|
| Agricultural, forestry & fishery | 79.5 | 50.4 | 34.0 | 17.9 | 8.7 |
| Mining & manufacturing | 5.4 | 14.3 | 22.5 | 27.6 | 20.6 |
| SOC* & others | 15.1 | 35.3 | 43.5 | 54.5 | 70.7 |

Source: Korean National Statistical Office, *Social Indicators in Korea* in Hong (2003:41)

* SOC (social overhead capital)

Table 2. Premium to Education Among Male Wage Labor

| | Brazil | | Korea | |
|--------------------------------|-------------------|-------------------|------------------|------------------|
| | 1976 | 1985 | 1976 | 1985 |
| Premium to primary schooling | 0.488 (55.68) | 0.449 (67.23) | 0.176 (19.66) | 0.092 (7.54) |
| Premium to secondary schooling | 0.958 (85.70) | 0.886 (110.53) | 0.473 (48.19) | 0.296 (23.40) |
| Premium to tertiary schooling | 1.593 (100.22) | 1.508 (127.40) | 0.969 (71.48) | 0.655 (42.06) |

Source: Birdsall, Ross and Sabot (1997:107)

Table 3. Employment Changes by Gender and Education (thousand, %)

| | April 1996 | April 1997 | April 1998 | 96/97 (%) | 97/98 (%) |
|------------------|------------|------------|------------|-----------|---------------|
| Total | 20,743 | 21,219 | 20,127 | 476 (2.3) | -1,092 (-5.1) |
| Gender | | | | | |
| Men | 12,349 | 12,446 | 11,976 | 97 (0.8) | -470 (-3.8) |
| Women | 8,395 | 8,773 | 8,151 | 378 (4.5) | -622 (-7.1) |
| Education | | | | | |
| Less HS degree | 7,637 | 7,715 | 6,870 | 78 (1.2) | -845 (-11.1) |
| HS degree | 9,009 | 9,163 | 8,582 | 154 (1.6) | -581 (-6.2) |
| College degree | 4,098 | 4,341 | 4,675 | 243 (6.4) | 334 (7.2) |

Source: Korean National Statistical Office, *The Economically Active Population Survey*

Table 4. Employment Change by Industry and Occupation

| | April 1997/ April 1998 (% Change) |
|-----------------------|-----------------------------------|
| Industry | |
| Agriculture / Fishery | 216 (8.8) |
| Manufacturing | -619 (-13.7) |
| Construction | -392 (-19.3) |
| Utility/Trans./FIRE | 11 (0.6) |
| Retail/Wholesale | -234 (-4.0) |
| Services | -66 (-1.5) |
| Occupation | |
| Prof./Administration | 15 (0.0) |
| Clerical | -117 (-4.5) |
| Sales/ Service | -103 (-2.1) |
| Operatives/Laborer | -1,072 (-13.9) |
| Farmers/ Fishers | 186 (7.9) |

Source: Korean National Statistical Office, *The Economically Active Population Survey*

Table 5. Changes in Employment Structure (%)

| | 1991 | 1994 | 1997 | 1999.3 | 2000 | 2001 | 2002 | 2003.3 |
|--------------------|------|------|------|--------|------|------|------|--------|
| Day Laborers | 15.7 | 14.3 | 14.1 | 17.4 | 17.6 | 16.2 | 17.2 | 14.9 |
| Temporary Workers* | 28.7 | 27.8 | 31.6 | 33.2 | 34.5 | 34.6 | 34.5 | 34.7 |
| Full-time workers | 55.5 | 57.9 | 54.3 | 49.4 | 47.9 | 49.2 | 48.4 | 50.4 |

Source: Korean National Statistical Office in Kim (2004:25)

Note: * Those employed from one month to less than a year

Table 6. Hourly Wages by Employment Type, 2000 (in won/hour)

| Duration of employment contract | Fixed-term contracts | | Contracts of an indefinite period | | |
|---------------------------------|----------------------|--------------------|-----------------------------------|--------------------|---------|
| | Less than one year | One year or longer | One year or longer | Less than one year | Average |
| Average | 3,894 | 7,632 | 6,364 | 3,520 | 6,061 |
| Regular | -- | 7,632 | 8,234 | 3,840 | 8,225 |
| Temporary | 4,165 | -- | 4,307 | 3,352 | 4,251 |
| Daily-hire | 3,766 | -- | 3,941 | 3,586 | 3,811 |

Source: Korean National Statistical Office (2000) in Yang and Moon (2005:84)

Table 7. Major Financial Liberalization Measures in Korea During the 1990s

| |
|--|
| <p>1) Interest rates deregulation (on four states: 1991 to July 1997)</p> <ul style="list-style-type: none"> - By 1997, all lending and borrowing rates, except the demand deposit rates, were liberalized |
| <p>2) More managerial autonomy to the banks and lower entry barriers to financial activities</p> <ul style="list-style-type: none"> - Freedom for banks to increase capital, to establish branches, and to determine dividends payments (1994) - Enlargement of business scopes for financial institutions (1993) <ul style="list-style-type: none"> : continuous expansion of the securities business of deposit money : freedom for banks and life insurance companies to sell government and public bonds over-the-counter (1995) : permission for the securities companies to handle foreign exchange business (1995) - Abolition of the limits on the maximum maturities in loans and deposits of banks (1996) |
| <p>3) Foreign exchange liberalization</p> <ul style="list-style-type: none"> - Adoption of the Market-Average Foreign Exchange Rate System (1990) - Easing of the requirement for documentation providing the deal (i.e., non-financial) demand in foreign exchange transactions (1991) - Setting up of foreign currency call markets - Revision of the Foreign Exchange Management Act (1991) <ul style="list-style-type: none"> : changing the basis for regulation from a positive system to a negative system - Introduction of 'free won' accounts for non-residents (1993) - Allowance of partial Won settlements for the export or import of visible items (1993) - Foreign Exchange Reform Plan (1994) <ul style="list-style-type: none"> : a detailed schedule for the reform of the foreign exchange market structure - A very significant relaxation of the Foreign Exchange Concentration System (1995) |
| <p>4) Capital market opening</p> <ul style="list-style-type: none"> - Foreign investors are allowed to invest directly in Korea stock markets with ownership ceilings (1992) - Foreigners are allowed to purchase government and public bonds issued at international interest rates (1994), equity-linked bonds issued by small-and-medium-sized firms (1994), non-guaranteed long term bonds issued by small-and-medium-sized firms (Jan. 1997), and non-guaranteed convertible bonds issued by large companies (Jan. 1997) - Residents are allowed to invest in overseas securities via beneficiary certificates (1993) - Abolition of the ceiling on the domestic institutional investors' overseas portfolio investment (1995) - Foreign commercial loans are allowed without government approval as far as they meet the guideline established in May 1995 - Private companies engaged in major infrastructure projects are allowed to borrow overseas to pay for domestic construction cost (Jan. 1997) - Liberalization of borrowings related to foreign direct investments related (Jan. 1997) |
| <p>5) Policy loans & credit control</p> <ul style="list-style-type: none"> - A planned termination of all policy loans by 1997 is announced (1993) <ul style="list-style-type: none"> : a step-wise reduction in policy loans to specific sectors (e.g., export industries and small and medium-sized firms) - Simplifying and slimming down of the controls on the share of bank's loans to major conglomerates in its total loans |

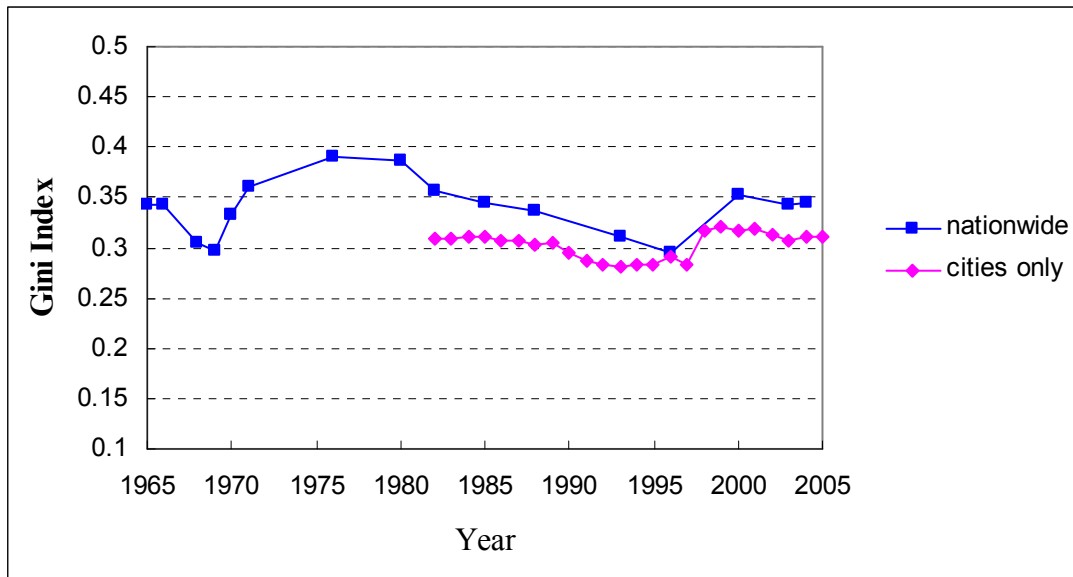
Source: Ministry of Finance and Economy in You and Lee (2000:30)

Table 8. Korea's Foreign Debt Profile, 1960-1997

| Year | Total debt (millions of dollars) | Share of short- term debt (%) | Foreign debt to GNP (%) |
|------|--|----------------------------------|----------------------------|
| 1960 | 83 | 1.2 | 3.9 |
| 1961 | 83 | n.a | 3.9 |
| 1962 | 89 | n.a | 3.8 |
| 1963 | 157 | 14.0 | 5.8 |
| 1964 | 177 | 5.6 | 6.1 |
| 1965 | 206 | 1.5 | 6.9 |
| 1966 | 392 | 1.8 | 10.7 |
| 1967 | 645 | 10.2 | 15.1 |
| 1968 | 1,199 | 7.4 | 22.9 |
| 1969 | 1,800 | 10.8 | 27.2 |
| 1970 | 2,245 | 16.6 | 28.1 |
| 1971 | 2,922 | 16.4 | 31.2 |
| 1972 | 3,587 | 17.8 | 33.9 |
| 1973 | 4,257 | 16.5 | 31.5 |
| 1974 | 5,933 | 20.9 | 32.0 |
| 1975 | 8,443 | 28.5 | 40.5 |
| 1976 | 10,350 | 28.9 | 36.7 |
| 1977 | 12,649 | 29.4 | 33.8 |
| 1978 | 14,823 | 21.3 | 28.5 |
| 1979 | 20,287 | 26.9 | 32.5 |
| 1980 | 27,170 | 34.5 | 44.4 |
| 1981 | 32,433 | 31.5 | 49.0 |
| 1982 | 37,083 | 33.5 | 52.0 |
| 1983 | 40,378 | 30.0 | 50.8 |
| 1984 | 43,053 | 26.5 | 49.5 |
| 1985 | 46,762 | 23.0 | 52.1 |
| 1986 | 44,510 | 20.8 | 42.3 |
| 1987 | 35,563 | 26.1 | 27.6 |
| 1988 | 31,150 | 31.4 | 18.0 |
| 1989 | 29,368 | 36.8 | 13.9 |
| 1990 | 31,700 | 45.3 | 13.3 |
| 1991 | 39,135 | 44.0 | 13.9 |
| 1992 | 42,819 | n.a. | n.a. |
| 1993 | 43,870 | 43.7 | 12.7 |
| 1994 | 56,850 | n.a. | 14.2 |
| 1995 | 78,439 | n.a. | 16.1 |
| 1996 | 104,695 | 58.3 | 20.2 |
| 1997 | 120,800 | n.a. | 25.5 |

Sources: Economic Planning Board and the Bank of Korea in Shin and Chang (2003:40)

Figure 1. Income Distribution in Korea, 1965-2004



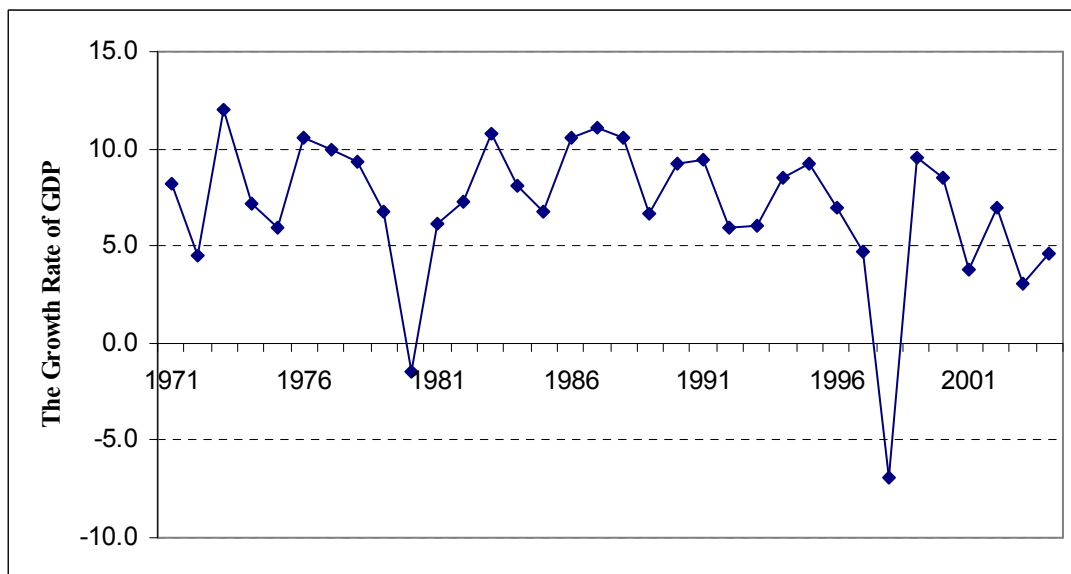
Sources of 'Nationwide': World Bank table by Deininger (1965-1988); Korean National Statistical Office (1996-2004)

Note: The unit is the nationwide households; the income reported is gross income

Source of 'Cities only': Cities only: Korean National Statistical Office, *Annual Report on the Household Income and Expenditure Survey*

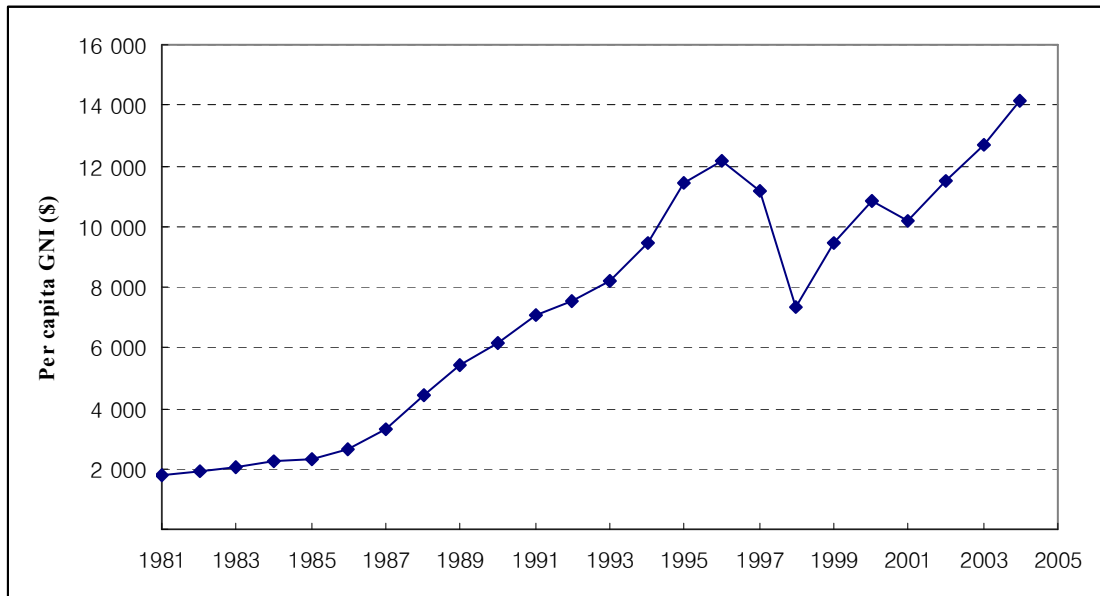
Note: Data are for salary & wage earner's households in all cities (73 cities)

Figure 2. The Growth Rate of GDP in Korea, 1971-2004



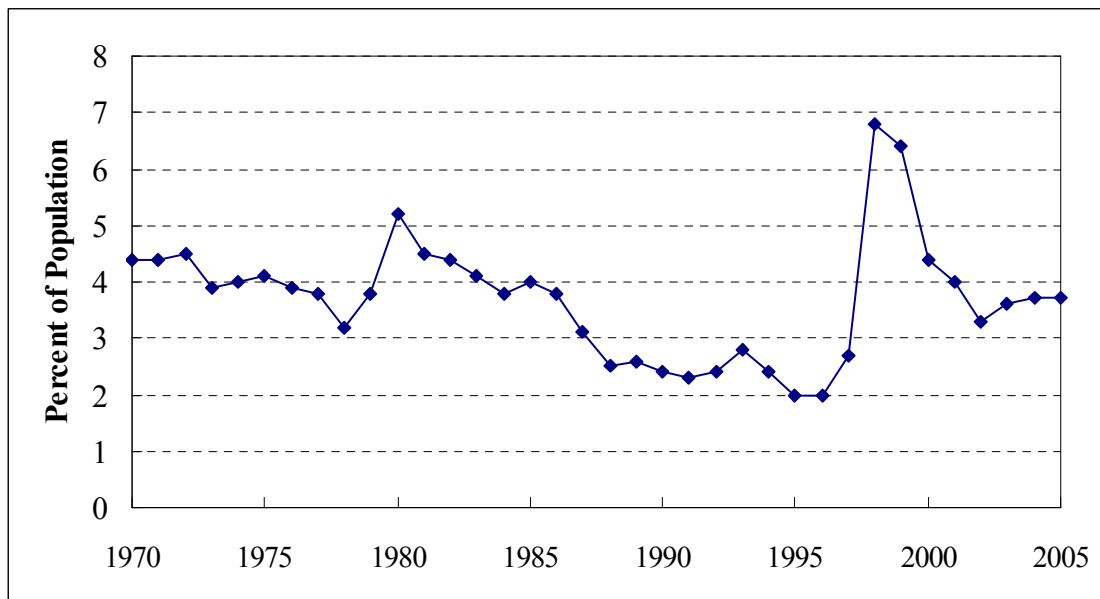
Source: The Bank of Korea, *Quarterly National Accounts*

Figure 3. Per Capita Gross National Income (GNI) in Korea, 1981-2004



Source: The Bank of Korea, *Quarterly National Accounts*

Figure 4. Unemployment Rate in Korea, 1970-2005



Source: Korean National Statistical Office, *The Economically Active Population Survey*

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